IT 05-5
Tax Type: Income Tax
Issue: Unitary – Inclusion of Company(ies) In A Unitary Group

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket No.	04-IT-0000
OF THE STATE OF ILLINOIS	)	FEIN	00-0000000
v.	)	Tax Years Ending	12/97 - 12/99
ABC CORPORATION,	)		
as successor to XYZ Corporation,	)	John E. White,	
Taxpayer	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION REGARDING
THE PARTIES' CROSS MOTIONS FOR SUMMARY JUDGMENT

Appearances: Brian Browdy & Michael Israel, Horwood Marcus & Berk, appeared for XYZ Corporation; David Dorner, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter involves the Illinois Department of Revenue's ("Department") denial of amended Illinois income tax returns XYZ Corporation ("XYZ")[1] filed regarding tax years ending December 31, 1997, December 31, 1998 and December 31, 1999. XYZ filed those amended returns to request replacement income tax investment credits, which XYZ claimed were authorized by § 201(e) of the Illinois Income Tax Act ("IITA"), for each of those years.

The parties filed cross motions for summary judgment on the question of whether XYZ is primarily engaged in retailing, as that term is defined in IITA § 201(e)(3). XYZ additionally sought judgment based on its claim that the Department's denial of its amended returns constituted an as-applied violation of the Illinois Constitution's uniformity clause. I am including within this order and recommendation a brief statement of the material facts not at issue. I recommend that the Department's motion be granted, and that XYZ's motion be denied.

Facts Not in Dispute:

1. Together with other corporations, XYZ conducted a single unitary business during tax years ending December 31, 1997 through December 31, 1999. *See* Memorandum of Law in Support of the Department's Motion for Summary Judgment (hereinafter, "Department Memo"), Ex. A (XYZ's Protest and Hearing Request, dated 11/17/03), p. 1 (¶ 2 of section designated, "Facts").

2. One of the members of XYZ's unitary business group is MMM ("MMM"), a wholly owned subsidiary. *See* Department Memo, Ex. A, p. 1 (¶ 2).

3. MMM was, during the years at issue, a public utility company principally engaged in the production, purchase, transmission, distribution and sale of electricity. Department Memo, Ex. A, p. 1 (¶ 3).

4. MMM purchased generation, transmission and distribution property that was depreciable pursuant to § 167 of the Internal Revenue Code, and placed such property in service in Illinois during the years at issue by using it to generate and transmit electrical power and delivering it to MMM's customers. *See* Department Memo, Ex. A, p. 1 (¶ 5). Such property had not previously been used in Illinois. Department Memo, Ex. A, p. 1 (¶ 5).

---

[1] After they filed their initial respective cross-motions, the parties agreed to substitute ABC Corporation, XYZ's successor, as the taxpayer in this contested case. Order, dated 3/8/05. For

5. XYZ timely filed Illinois combined income tax returns for tax years ending December 31, 1997 through December 31, 1998. Department Memo, Ex. A, p. 1 (¶¶ 1-2).

6. On its original combined Illinois returns, neither XYZ nor MMM claimed any amount as a credit authorized by IITA § 201(e). Department Memo, Ex. A, p. 1 (¶ 4).

7. On April 10, 2003, XYZ timely filed amended Illinois combined income tax returns on which it claimed, respectively, a § 201(e) credit for its 1997 tax year in the amount of $5,237,334.00, a § 201(e) credit for its 1998 tax year in the amount of $6,517,482.00, and a § 201(e) credit for its 1999 tax year in the amount of $3,111,659.00. Department Memo, Ex. A, p. 2 (¶¶ 6-8).

8. On November 17, 2003, XYZ, citing IITA § 909(e), filed a protest of the Department's deemed denial of the amended returns XYZ filed on April 10, 2003, regarding tax years ending December 31, 1997 through December 31, 1999. Department Memo, Ex. A, pp. 2 (¶¶ 10-11), 8.

Conclusions of Law:

This matter involves whether XYZ, the parent of a public electric utility company, is entitled to a § 201(e) credit for property used to produce, transmit and distribute electricity. When a person seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981) (*citing* Bodine Electric Co. v. Allphin, 81 Ill.2d 502, 410 N.E.2d 828 (1980); Telco Leasing, Inc. v. Allphin, 63 Ill.2d

---

convenience, I will continue to refer to taxpayer as XYZ throughout this recommendation.

305, 347 N.E.2d 729 (1976)). The parties elected to proceed via cross-motions for summary judgment.

Summary judgment is appropriate when resolution of the case hinges on a question of law. First of America Bank, Rockford, N.A. v. Netsch, 166 Ill. 2d 165, 651 N.E. 2d 1105 (1995); Kirk Corp. v. Village of Buffalo Grove, 248 Ill. App. 3d 1077, 618 N.E. 2d 789 (1st Dist. 1993). Summary judgment is also appropriate when the parties dispute the correct construction of an applicable statute. Bezan v. Chrysler Motors Corp., 263 Ill. App. 3d 858, 636 N.E. 2d 1079 (2nd Dist. 1994). Where both parties file motions for summary judgment, only a question of law is raised. Lake Co. Stormwater Mgmt. Comm. v. Fox Waterway Agency, 326 Ill. App. 3d 100, 104, 759 N.E.2d 970, 973 (2d Dist. 2001). Because this matter involves the parties' cross-motions for summary judgment regarding an issue on which taxpayer bears the burden of proof, XYZ bears the burden of showing, as a matter of law, that it has a clear right to the credit claimed. *See* Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238.

Section 201(c) of the IITA imposes what is commonly referred to as a replacement tax on every corporation, partnership and trust, for the privilege of earning or receiving income in or as a resident of Illinois. 35 ILCS 5/201(c). Section 201(e) grants a credit that may be applied against a person's replacement tax liability for investment in qualified property. 35 ILCS 5/201(e). Specifically, § 201(e) provides:

> (e) Investment credit. A taxpayer shall be allowed a credit against the Personal Property Tax Replacement Income Tax for investment in qualified property.
>
> (1) A taxpayer shall be allowed a credit equal to .5% of the basis of qualified property placed in service during the taxable year, provided such property is placed in service on or after July 1, 1984.
>
> ***

> (2) The term "qualified property" means property which:
>
> (A) is tangible, whether new or used, including buildings and structural components of buildings and signs that are real property, but not including land or improvements to real property that are not a structural component of a building such as landscaping, sewer lines, local access roads, fencing, parking lots, and other appurtenances;
>
> (B) is depreciable pursuant to Section 167 of the Internal Revenue Code, except that "3-year property" as defined in Section 168(c)(2)(A) of that Code is not eligible for the credit provided by this subsection (e);
>
> (C) is acquired by purchase as defined in Section 179(d) of the Internal Revenue Code;
>
> (D) is used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing; and
>
> (E) has not previously been used in Illinois in such a manner and by such a person as would qualify for the credit provided by this subsection (e) or subsection (f).
>
> (3) For purposes of this subsection (e), “manufacturing” means the material staging and production of tangible personal property by procedures commonly regarded as manufacturing, processing, fabrication, or assembling which changes some existing material into new shapes, new qualities, or new combinations. For purposes of this subsection (e) the term “mining” shall have the same meaning as the term “mining” in Section 613(c) of the Internal Revenue Code. For purposes of this subsection (e), the term “retailing” means the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities.

35 ILCS 5/201(e) (emphasis added).

The general point of law the parties dispute is whether MMM, a public electric utility company, is primarily engaged in retailing, as that term is defined in § 201(e)(3).

The Department’s Motion

The Department argues it is entitled to judgment as a matter of law because there is no dispute that XYZ is engaged in the production, purchase, transmission, distribution and sale of electricity, and because “[t]he Illinois Supreme Court has consistently ruled that electricity is not a tangible, but is an intangible. Thus, taxpayer is not engaged in 'retailing' because it is does not sell tangible personal property." Department Memo, p. 2.

The Department cites Farrand Coal Co. v. Halpin, 10 Ill. 2d 507, 140 N.E.2d 698 (1957), as the case in which the Illinois Supreme Court most recently held that electricity is not tangible personal property. Department's Brief, pp. 7-9. That case involved Farrand Coal Co.'s sales of coal to a purchaser who was engaged in the business of producing and selling electricity. Farrand Coal Co. paid the tax attributable to such sales under protest, then filed an action to have the tax monies returned to it, and to have the court declare that such sales were sales of tangible personal property for resale. Farrand Coal Co., 10 Ill. 2d at 508, 140 N.E.2d at 699.

Farrand Coal Co. claimed that its sales to a utility company were really its sales of energy contained within the coal, and which the purchaser merely converted into electrical energy, thereby making the coal a constituent part of the electrical energy the utility was engaged in the business of selling. *Id*., 10 Ill. 2d at 508-09, 140 N.E.2d at 699. The Court rejected the retailer's argument generally, and specifically rejected the argument that a utility is engaged in the business of selling electrical energy as tangible personal property:

> Although this court recognizes electricity as personal property, it has at no time held electricity to be "tangible" personal property. In *Peoples Gas Light and Coke Company v. Ames*, 359 Ill. 152, it was held that gas and electric public utilities were engaged in a service business and not subject to the retailers' occupation tax, and decision as to whether or not electricity was tangible personal property was expressly declined as unnecessary to a disposition of the case.
>
> In *People v. Menagas*, 367 Ill. 330, electric current was held to be a subject of larceny under the Illinois Criminal Code. Such decision held only that electric current and energy was personal property as distinguished from real property, and in fact on pages 333 and 338 the court twice referred to electrical energy as being intangible.

> Most of the authorities relied on by plaintiff holding electricity to be tangible personal property are from foreign jurisdictions involving statutes specifically declaring electricity to be such. Of course, such definition is not present in the instant statute here in issue. The other cases relied on by plaintiff hold electric utility companies to be engaged in manufacturing commodities. Such cases are contrary to the holding of this court in *People ex rel. Mercer v. Wyanet Electric Light Co.* 306 Ill. 377, that electric utility companies are neither manufacturing nor mercantile companies so as to have their capital stock assessed locally instead of by the State assessing authority.
>
> ***
>
> The sale of electrical energy generated by the utility through the use or consumption of coal as a service to the utility customers is not, within the ordinary meaning of the statutory language, a sale "of tangible personal property [coal], which property as an ingredient or constituent goes into and forms a part of tangible personal property [electrical energy] subsequently the subject of a 'sale at retail.' "

Farrand Coal Co., 10 Ill. 2d at 512-13, 140 N.E.2d at 701 (emphasis added).

The Farrand Coal Co. decision, and the other cases cited therein, firmly establish that the Illinois Supreme Court has, long ago and consistently, determined that electric utility companies are not engaged in the business of selling tangible personal property, as that term is used in the ROTA, and that they are instead engaged in business as providers of other services. *See, e.g.*, Illinois Bell Telephone Co. v. Ames, 364 Ill. at 369-70; Peoples Gas, Light and Coke Co. v. Ames, 359 Ill. 152, 157-58 (1935) (public utility companies not subject to Retailers' Occupation Tax, in part, because Illinois' Public Utilities Act described "[t]he furnishing of any commodity … as 'service.'"); *see also* People ex rel. Mercer v. Wyanet Electric Light Co., 306 Ill. 377 (1923) (public utility company was not "organized for purely manufacturing and mercantile purposes" so as to exempt it from paying tax on its capital stock). The Department's motion argues that it is perfectly appropriate to consider the Illinois Supreme Court's long-standing determination that providers of electricity are not engaged in selling tangible personal property, as that term is used in the ROTA, when attempting to decide whether providers of electricity are primarily engaged in retailing as that term is defined in the IITA, and whose definition similarly depends on whether a person is engaged in the business of selling tangible personal property. Department Memo, pp. 8-9.

The Farrand Coal Co. Court's long-standing holding that providers of electricity are engaged in a service occupation, and not engaged in selling tangible personal property, is applicable to the question of whether such persons are primarily engaged in retailing, as that term is defined in IITA § 201(e)(3). Here, for example, the Department cites to the applicable Illinois income tax regulation, and others in effect during the years at issue, and to a recent Illinois appellate court decision interpreting § 201(e)(3) of the IITA, to support its motion for summary judgment. Department Memo, pp. 9-11.

During the years at issue, Illinois income tax regulation ("IITR") § 100.2100(c) provided a description of those activities that the Department declared would not constitute retailing. That applicable regulation provided, in pertinent part:

> 9) Retailing. Retailing is defined as the sale of tangible personal property. … The following activities are not considered retailing operations:
>
> ***
>
> C) Other service professions which do not involve the transfer of tangible personal property other than as an incident to the service performed. For guidance in distinguishing service professions from retailing professions, the Department will rely on rules promulgated under the Service Occupation Tax Act at 86 Ill. Adm. Code 140;
>
> ***

86 Ill. Admin. Code § 100.2100(c)(9) (1985). Section 140.125 of Illinois' Service Occupation Tax Act ("SOTA") regulations, in turn, expressly provides that service

occupation tax does not apply to transfers of intangible personal property. 86 Ill. Admin. Code § 140.125(a). Thus, the regulation the Department specifically adopted to administer and enforce the provisions of IITA § 201(e)(3) reflects the applicability of the Court's Farrand Coal Co. decision to a determination of whether a person is primarily engaged in retailing, and thus entitled to a IITA § 201(e) credit. 86 Ill. Admin. Code § 100.2100(c)(9) (1985). Providers of electricity, as sellers of services, are not primarily engaged in retailing, as that term is defined in IITA § 201(e)(3). *Id*.; 86 Ill. Admin. Code § 140.125.

The Illinois Appellate Court's decision in Schawk, Inc. v. Zehnder, 326 Ill. App. 3d 752, 761 N.E.2d 192 (1st Dist. 2001) also reflects how the same reasoning the Court used in Farrand Coal Co., and the decisions cited therein, are applicable to the IITA. Schawk involved a taxpayer's claim to a § 201(e) credit against its replacement tax liability. *Id*. Schawk produced and sold color-separated film used by its customers to print packaging materials for consumer products such as cereal boxes, promotional materials and in-store displays. *Id*. at 753, 761 N.E.2d at 193. Schawk claimed entitlement to a § 201(e) credit because, it said, it was primarily engaged in manufacturing, as that term is defined in § 201(e)(3). *Id*. at 754-55, 761 N.E.2d at 194.

The court, however, held that Schawk was not entitled to a § 201(e) credit because it was engaged in a service business, and that its service business was not included within IITA § 201(e)(3)'s definition of manufacturing. Schawk, 326 Ill. App. 3d at 755, 761 N.E.2d at 195 ("We find that the plain language of the statute at issue is clear and that the activities engaged in by Schawk are not embraced under the statute's definition of manufacturing.") The court further held that "the inclusion of Schawk's business in the classification 'manufacturing' is inconsistent with Illinois precedent classifying the graphic arts as a service occupation in the context of other tax statutes." *Id*. at 756, 761 N.E.2d at 195.

Further, the law upon which the Schawk court based its decision that Schawk was not engaged in manufacturing included decisions the Illinois Supreme Court entered in cases involving the definition of manufacturing as that term is used or defined in the acts that, together, make up Illinois' sales tax laws. *See* Weber-Stephen Products, Inc. v. Department of Revenue, 324 Ill. App. 3d 893, 898, 756 N.E.2d 321, 324 (1st Dist. 2001). Specifically, the Schawk court wrote:

> Although the forgoing cases involve the differentiation of service occupations from retail occupations, our supreme court in *Colorcraft Corp. v. Department of Revenue,* 112 Ill. 2d 473, 98 Ill.Dec. 45, 493 N.E.2d 1066 (1986), has adopted its test for service occupations in order to differentiate them from manufacturing, and is squarely on point. The *Colorcraft* court held that photo finishing services constitute services rather than manufacturing for the purpose of an exemption available to manufacturers under the Use Tax Act (Ill.Rev.Stat.1983, ch. 120, par 439.3). In *Colorcraft* the taxpayer was a business which processed color film into finished photographs for consumers. The taxpayer argued that it was engaged in the business of manufacturing and thus its photo finishing equipment was exempt from the use tax. The statute at issue defined manufacturing similarly to the statute at issue in the instant case. [FN2]
>
> FN2 Section 3 of the Use Tax Act defined "manufacturing process" as "the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name." Ill.Rev.Stat.1983, ch. 120, par. 439.3, quoted in, *Colorcraft,* 112 Ill.2d at 476-77, 98 Ill.Dec. 45, 493 N.E.2d at 1067.

> The *Colorcraft* court reasoned that the graphic arts had been classified as service occupations rather than retail sales in several earlier cases construing the Retailer's Occupation Tax Act. *H.G. Adair Printing Co.*, 364 Ill. 342, 4 N.E.2d 481; *A.B.C. Electrotype Co.*, 364 Ill. 360, 4 N.E.2d 476; *J.A. Burgess Co.*, 359 Ill. 427, 194 N.E. 565. The *Colorcraft* court noted that our supreme court in *Spagat* had articulated a test to determine if a business is engaged in a service or retail occupation.

Schawk, 326 Ill. App. 3d at 757-58, 761 N.E.2d at 196-97.

In sum then, the Illinois Supreme Court has long held that providers of electricity are not engaged in the business of selling tangible personal property. The Illinois appellate court has, in Schawk, more recently held that a person that was primarily engaged in a service occupation was not entitled to claim a § 201(e) credit. While the specific issue in Schawk involved the definition of manufacturing and not retailing, the court clearly relied upon the Illinois Supreme Court's long-standing distinction, for purposes of the ROTA and the complimentary Use Tax Act, to decide that the person's activities did not meet the definition set forth in IITA § 201(e)(3). Finally, the IITR the Department adopted to administer and enforce IITA § 201(e) states that service providers are not engaged in retailing, as that term is defined in IITA § 201(e)(3). Those legal determinations are all applicable to the undisputed material facts established by this record. After applying the undisputed facts to those legal determinations, I conclude, as a matter of law, that MMM is not primarily engaged in the business of retailing, as that term is defined in IITA § 201(e)(3).

XYZ's Motion

XYZ argues that it is primarily engaged in retailing because, "as a matter of scientific fact and settled income tax law, electricity is tangible property." Taxpayer's Response to Department's Motion for Summary Judgment and Taxpayer's Cross-Motion for Summary Judgment ("XYZ's MSJ"), p. 1 (Introduction). XYZ bases its claim that electricity is tangible personal property, as a matter of federal income tax law, on IITA § 102. *Id*., p. 4. It argues that electricity is tangible personal property, as a matter of scientific fact, based on the opinion of Joel Fajans ("Fajans"), a Ph.D. and physics professor at the University of California, Berkley. *Id*. pp. 5-7. & Exhibits A (Fajans' Affidavit), A-1 (Fajans' report prepared for XYZ), A-2 (Fajans' curriculum vitae), thereto. I address each of XYZ's assertions separately.

Does IITA § 102 Require That "Tangible Personal Property," As Used In IITA § 201(e)(3), Have The Same Meaning As It May Have Pursuant To A Provision In The Internal Revenue Code

XYZ argues that the Department's reliance on the Illinois Supreme Court's decision in <u>Farrand Coal</u> "is foreclosed by the [IITA's] own internal rule of statutory construction." XYZ's MSJ, p. 4. XYZ asserts that, "The [IITA's] own interpretive guide holds that where, as here, the definition of a word is not found in the income tax statute itself, we look to for its meaning not in the sales tax statutes, or in the decades-old court opinions interpreting them, but rather in the Internal Revenue Code and the federal income tax laws as we find them today." *Id*. XYZ cites to § 102 of the IITA to support its assertion about what that provision "holds." *Id*. Thus, my analysis of this part of XYZ's motion intertwines the questions of whether the term tangible personal property, as used in IITA § 201, must be deemed to have the same meaning as that term has when used in a particular IRC provision, as well as the question of whether it is settled federal law that electricity constitutes tangible personal property.

I first note that XYZ never actually quotes the text of IITA § 102 within its motion and memoranda. This is curious, since that provision is the sole basis for XYZ's argument that I must ignore the Illinois Supreme Court's prior judicial construction of the term tangible personal property in Farrand Coal Co., when deciding whether, for purposes of IITA § 201(e), an electrical utility is primarily engaged in the business of retailing, and where retailing is defined, in essence, as selling tangible personal property. That is to say, XYZ is arguing that IITA § 102 requires me to ignore the otherwise prevailing presumption that, when it drafted IITA § 201(e)(3)'s definition of retailing, the Illinois legislature knew of and agreed with the Illinois Supreme Court's judicial construction of the term tangible personal property, as it related to the occupation of retailing. Carver v. Bond/Fayette/Effingham Reg. Bd. of School Trustees, 146 Ill. 2d 347, 353, 586 N.E.2d 1273, 1276 (1992); Christ Hospital & Medical Center v. Ill. Comprehensive Health Ins. Plan, 295 Ill. App. 3d 956, 961, 693 N.E.2d 1237, 1241 (1st Dist. 1998) ("we may presume that the legislature, when drafting the language of section 7(e)(2), was aware of the construction and use of the term [medical assistance] in [another Illinois statute]"). In any event, it behooves me to at least directly address the text of IITA § 102, to see whether XYZ is correct in arguing that that provision entitles it to judgment as a matter of law.

Section 102 of the IITA provides as follows:

> Construction.
>
> Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income

> taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year.

35 ILCS 5/102.

The plain text of IITA § 102 conditions the incorporation of the meaning of a term used in the IRC to, first, those situations where the context in which a term is used in the IITA does not make the term's meaning clear, and second, to those situations where the term used in the IRC is used in a context that is comparable to the context in which the term is used within the IITA. Thus, it is appropriate to consider here whether the context in which the term tangible personal property is used within the IITA makes the meaning of that term clear. It is also appropriate to consider whether the context in which tangible personal property appears in the IRC is comparable to the context in which the term appears in the IITA. 35 ILCS 5/102.

The term tangible personal property is used twice in IITA § 201(e)(3), first in the definition of manufacturing, and next in the definition of retailing. 35 ILCS 5/201(e)(3). In between those definitions, the General Assembly defines "mining" by expressly adopting the meaning of the same term as set forth in § 613(c) of the IRC. *Id*. So, within § 201(e)(3) itself, the legislature has plainly articulated which of the three defined classes of persons entitled to a credit is to be governed by the meaning of the same term when used in a comparable context within the IRC. It is not unreasonable to conclude, then, that the plain text of IITA § 201(e)(3) clearly reflects that the Illinois General Assembly did *not* intend its definitions of retailing or manufacturing to be governed by the IRC.

Further, under basic rules of statutory construction, where the same words appear in different parts of the same statute, they should be given the same meaning unless something in the context indicates that the legislature intended otherwise. Guillen v. Potomac Insurance Co. of Illinois, 203 Ill. 2d 141, 152, 785 N.E.2d 1, 8 (2003). Since the legislature repeatedly used the same term within § 201 and elsewhere within the IITA, it is reasonable to conclude that the legislature intended the term to have the same meaning, unless some language in the text of those different sections indicate that the legislature intended the term to have different meanings in different sections. Montano v. City of Chicago, 308 Ill. App. 3d 618, 624, 720 N.E.2d 628, 633 (1st Dist. 1999) ("When the same word is used twice in close proximity, there is a presumption that the word has the same meaning in both places."). The term tangible personal property is used repeatedly in Article 3 of the IITA, which sets forth the Act's apportionment and allocation provisions. The text and context of the legislature's use of the term within sections in Article 3 make abundantly clear that for purposes of the IITA, the legislature intended tangible personal property to mean something other than intangible property.

For example, IITA § 303 provides for the allocation of nonbusiness income by nonresidents of Illinois. 35 ILCS 5/303. In subparagraphs (a)(2) and (a)(3) of that section, the Illinois General Assembly distinguished between how items of nonbusiness income are to be allocated to Illinois, depending on whether the income was derived from a nonresident's transactions involving tangible personal property, or from transactions involving intangible property. The applicable parts of § 303(a) provide:

> (2) Tangible personal property. Capital gains and losses from sales or exchanges of tangible personal property are allocable to this State if, at the time of such sale or exchange:
>
> (A) The property had its situs in this State; or
>
> (B) The taxpayer had its commercial domicile in this State and was not taxable in the state in which the property had its situs.

> (3) Intangibles. Capital gains and losses from sales or exchanges of intangible personal property are allocable to this State if the taxpayer had its commercial domicile in this State at the time of such sale or exchange.
>
> ***

35 ILCS 5/303(a)(2)-(3). This legislative distinction between tangible personal property and intangible personal property was present in the original IITA, first enacted in 1969. Ill.Rev.Stat. ch. 120, ¶ 3-303(a)(2)-(3) (1969).

The phrase tangible personal property is also used within IITA § 304. 35 ILCS 5/304. That section requires nonresidents who earn income within and outside Illinois to apportion items of business income using separate payroll, property and sales factors. 35 ILCS 5/304(a). During the years at issue, MMM was required to use three-factor apportionment. Taxpayer's Reply, Ex. 2, pp. 2, 4, 6. Section 304(a)(1) describes which items of expense shall be included within the numerator and denominator of the property factor. 35 ILCS 5/304(a)(1). During the years at issue, it required taxpayers to include in the numerator of their property factor "the average value of the person's real and tangible personal property owned or rented and used in the trade or business in this State during the taxable year …." 35 ILCS 5/304(a)(1). Similarly, § 304(a)(3) describes how a multistate taxpayer must apportion its sales, and creates a fraction that compares the taxpayer's sales in Illinois versus its sales everywhere. 35 ILCS 5/304(a)(3)(A). The section sets forth different criteria for whether a person's sales are in Illinois, and those criteria differ depending on whether its sales are sales of tangible personal property or whether its sales are of "other … than tangible personal property …." 35 ILCS 5/304(a)(3)(B)-(C). Again, this legislative distinction between tangible personal property and property "other … than tangible personal property" was present in the original IITA, first enacted in 1969. Ill.Rev.Stat. ch. 120, ¶ 3-304 (1969).

The corollary to the rule that the same words, when used repeatedly within a statute, should be given the same meaning unless something in the context indicates that the legislature intended otherwise, is that when the legislature uses certain language in one part of a statute and different language in another, courts will assume that different meanings were intended. Carver v. Bond/Fayette/Effingham Reg. Bd. Of School Trustees, 146 Ill. 2d 347, 353, 586 N.E.2d 1273, 1276 (1992). The Illinois General Assembly has juxtaposed, within the IITA, the term tangible personal property with the term "intangible personal property" and with the phrase "[property] other than … tangible personal property." 35 ILCS 5/303(a)(2)-(3), 5/304(a)(1), (3)(B)-(C). That express legislative juxtaposition — that context — makes clear that the former was not intended to include either of the latter.

XYZ's motion, in this regard, does not seriously address the effect that accepting its argument that tangible personal property includes electricity would have on the other provisions of the IITA in which the legislature used the identical phrase. Again, if the meaning of tangible personal property under federal law affects the meaning of tangible personal property when used in IITA § 201(e)(3), then it must also affect the meaning of the identical term when used in other parts of the IITA. To be consistent with its own argument, therefore, XYZ should have followed IITA § 304(a)(3)(B)(i) when determining which of its sales were in Illinois, because it considered its sales of electricity to be sales of tangible personal property. Similarly, if, as XYZ argues, tangible personal property includes electricity, then pursuant to IITA § 304(a)(1)(A), it should have included the value of the electricity it used in its business in Illinois in its Illinois property numerator.

This record does not disclose whether XYZ did either, although XYZ asserts in its reply that it would not have had to include in its property factor numerator the value of the electricity it used in its business in Illinois, because "electricity is a demand commodity, produced and consumed the moment it is needed …." Taxpayer's Reply, p. 10. I have no idea what "demand commodity, produced and consumed the moment it is needed" means. I do know, however, that, in the Indiana tax court case that XYZ cites for the proposition that electricity is a "demand commodity," the court based that proposition on the premise that electricity cannot be stored. Indiana-Kentucky Electric Corp. v. Indiana Department of State Revenue, 598 N.E.2d 647, 650 (Ind. Tax Ct. 1992) ("Electricity cannot be stored, therefore, it must be produced the moment it is demanded."). This is an odd argument for XYZ to make, since the premise it relies on directly contradicts its own witnesses' opinion of one the fundamental qualities of electricity. XYZ's MSJ, Ex. 1 (Fajan's report), p. 1 ("Electricity … can be sensed (felt, tasted, seen, and heard,) measured, weighed and stored …."). But more to the point, XYZ fails to explain why, even if electricity were a "demand commodity," such a commodity should be considered tangible personal property for purposes of IITA § 201(e)(3), but not for purposes IITA § 304(a)(1)(A). *See* Taxpayer's Reply, *passim*.

There are only two possibilities, the legislature either: (1) intended the term tangible personal property to have the same meaning regardless where the term is used in the IITA, or; (2) intended the term to mean one thing in § 201(a)(3) but something else when used in different sections of the IITA. The best evidence of such intent is ordinarily found within the statutory text (*see* Kraft v. Edgar, 138 Ill. 2d 178, 189, 561 N.E.2d 656, 661 (1990)), yet nothing within the text of the sections in which the term is used in the IITA makes me conclude that the legislature intended the latter. Following the same logic, if federal law applies to the meaning of tangible personal property, it must apply wherever it is used in the IITA. Similarly, just as tangible personal property cannot mean one thing in § 201(e)(3) and something else in §§ 303 and 304, it cannot mean one thing for XYZ, and something else for every other Illinois taxpayer. The Department does not consider (Department Memo, p. 2), and for the past several decades has not considered, electricity to be included within the statutory term tangible personal property. Farrand Coal Co., 10 Ill. 2d at 512-13, 140 N.E.2d at 701. From the first day the IITA was passed, the Illinois General Assembly has distinguished tangible personal property from intangible personal property and from property other than tangible personal property. Ill.Rev.Stat. ch. 120, ¶¶ 3-303(a)(2)-(3), 3-304 (1969). Thus, XYZ's motion calls for a real and substantial change in the meaning of a term within different provisions of the IITA — the effect of which would extend well beyond this contested case — yet XYZ's Motion and briefs wholly ignore that effect.

Nor can XYZ brush away the Department's consistency argument by pointing to entries on copies of returns it attached to its reply brief, and by then suggesting that it does not matter, *in this case*, whether it took into account the value of the electricity it used in its business in Illinois when calculating its Illinois property factor numerator. Taxpayer's Reply, p. 10. XYZ characterizes the Department's reasoning as a statutory red herring because its Illinois property factor already approaches 99 to 100%. Taxpayer's Reply, p. 10. The point of the Department's argument was twofold — to point out that XYZ had not established that it acted consistently with its argument that tangible personal property as used in the IITA includes electricity, and to note the likely effect of such consistent action. By focusing on the fact that almost all of its real and tangible personal property is situated in Illinois, XYZ avoided any direct acknowledgement of whether it included the value of that property in its Illinois property factor numerator. Further, while it *may* be true that XYZ's Illinois property factor would not have increased had it included therein the value of the electricity it used in its business in Illinois, the returns XYZ appended to its reply do not reflect whether it did so. Nor do those returns reveal the total value of the electricity XYZ used in its business in Illinois during the years at issue. Before I, or anyone else, could conclude that XYZ's reply argument is correct, I would have to know both of those facts.

I now return to XYZ's claim that it is "settled federal income tax law" that electricity constitutes tangible personal property. The first thing to notice about this proposition is the nature of the authority XYZ cites to support it. For example, XYZ does not cite to a particular section of the IRC whose text provides that tangible personal property includes electricity. Nor does XYZ cite to a properly promulgated federal regulation in which the Department of the Treasury has adopted a regulation in which it announced to the public, following notice and comment, that tangible personal property includes electricity. Finally, XYZ cites to no precedential or persuasive judgment entered by a federal court in a case involving a dispute regarding the meaning of such term, as used in the applicable federal tax statute or regulation.

Instead, XYZ cites to three private letter rulings ("PLR's"), a chief counsel advisory ("CCA") and a technical advice memorandum ("TAM") written and, after being redacted, published by the IRS. XYZ's Motion, p. 4; 2001 WL 1659980 (Sept. 25, 2001) (IRS PLR); 2001 WL 1638435 (IRS CCA) (Sept. 18, 2001); 2001 WL 1451836 (IRS PLR) (June 20, 2001); 2001 WL 1451856 (IRS PLR) (Aug. 14, 2001); 1995 WL 397457 (IRS TAM) (Feb. 15, 1995). In other words, the authority XYZ relies on to support its argument that, as a matter of settled federal income tax law, electricity is tangible personal property, consists of the mere position statements of the IRS. *Id.*

Contrary to XYZ's argument, moreover, what *is* a matter of settled federal income tax law is that IRS determinations like the ones cited by XYZ here have no value whatever as precedent. 26 U.S.C. § 6110(j)(3). Indeed, each of the documents cited by XYZ includes the statement, "This document may not be used or cited as precedent[,]" followed by a citation to IRC § 6110(j)(3). Section 6110(j)(3) of the IRC provides:

> Precedential status
> Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent. The preceding sentence shall not apply to change the precedential status (if any) of written determinations with regard to taxes imposed by subtitle D of this title.

26 U.S.C. § 6110(j)(3).[2] XYZ, therefore, is wrong — as a matter of federal law — to argue that the question of whether electricity constitutes tangible personal property is "settled." *Compare* XYZ's MSJ, p. 4 *with* 26 U.S.C. § 6110(j)(3)).

As the Department correctly notes, it is perfectly appropriate for a court to ignore an argument supported only by reference to determinations subject to IRC § 6110(j)(3). Department's Response to [XYZ's] Cross-Motion for Summary Judgment and Reply to [XYZ's] Response to the Department's Motion for Summary Judgment ("Department's

---

2 Subtitle D of title 26 is titled "Miscellaneous Excise Taxes," and that subtitle includes §§ 4000 to 5000 of the IRC. 26 U.S.C. §§ 4001 – 5000. Those sections have no applicability here.

Response"), p. 7 (*citing* Fox Valley & Vicinity Const. Workers Pension Fund v. Brown, 897 F.2d 275, 280 (7^{th} Cir. 1989)); *see also* Illinois Supreme Court Rule 341(e)(7) (an appellant's brief must contain, among other things, "the contentions of the appellant and the reasons therefor, with citation of the authorities … relied on. …"). While Illinois Supreme Court Rule 341(e)(7) does not apply to the Department's Office of Administrative Hearings, it is perfectly appropriate for the agency, when confronting a party's motion for judgment as a matter of law, to reject a legal proposition for which the movant offers no authority at all. *See, e.g.*, Purtill v. Hess, 111 Ill. 2d 229, 240, 489 N.E.2d 867, 871 (1986) (summary judgment "is a drastic means of disposing of litigation and therefore should be allowed only when the right of the moving party is clear and free from doubt.").

For IITA § 102 to apply to this dispute, XYZ first had to establish that the text of IITA § 201(e)(3)'s definition of retailing, and the context of the Illinois General Assembly's use of the term tangible personal property in the IITA, do not make the meaning of that term clear. XYZ has not carried that burden, because the meaning of that term is made clear both within IITA § 201(e)(3), itself, and within the other sections of the IITA in which it is used. This conclusion is one of law, however, and an agency's conclusions on questions of law are not entitled to the deference that is given to its findings of fact. Hercules Inc. v. Department of Revenue, 324 Ill. App. 3d 329, 335, 753 N.E.2d 418, 424 (1^{st} Dist. 2001). Thus, I have also addressed XYZ's argument that "it is a matter of settled federal income tax law that electricity is tangible [personal] property." This sounds like a question of fact (i.e., is proposition X, in fact, settled?), but it is really a question of law, since the "evidence" that will prove whether the proposition is settled will be a citation to a statute, regulation or appellate court decision that is on point. On this proposition, XYZ has not presented any legal authority whatever, and it has misrepresented that certain IRS determinations have settled a specific question of federal income tax law. At a minimum, XYZ has not established a clear right to judgment as a matter of law on the question of whether electricity constitutes tangible personal property for purposes of the IRC. This conclusion, however, is again, one of law. That is to say, a court might, notwithstanding IRC § 6110(j)(3), decide to entertain XYZ's argument that electricity is considered to be tangible personal property, at least for purposes of some particular section of the IRC. Thus, I complete this section by addressing the last clause of IITA § 102.

Even if the meaning of tangible personal property *were* a matter of settled federal income tax law, IITA § 102 still provides that the meaning of a term appearing in the IITA "shall have the same meaning as when used in a comparable context in the [IRC] …." 35 ILCS 5/102; *see also* Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 509, 410 N.E.2d 828, 831 (1980) ("[IITA § 102 does] not, by itself, incorporate substantive provisions of the Code such as section 172, so as to allow a State taxpayer to compute a net operating loss on a State tax return"). The important point here is that an examination of the context in which terms are used in different statutory provisions can often require an examination of the purposes underlying each provision. Christ Hospital & Medical Center, 295 Ill. App. 3d at 961, 693 N.E.2d at 1241 ("We recognize the limitations in importing definitions from other statutes since the context in which a term is used bears on its intended meaning."); Town of Normal v. Harter, 5 Ill. App. 3d 363, 366, 283 N.E.2d 44, 46 (1972) ("text must be read in context and the context here is the legislative purpose."). The context in which tangible personal property is used in the IRC sections discussed in the documents cited by XYZ, however, is *not* comparable to the context in which the term is used in the IITA.

Within the narrow context of IITA § 201(e)(3), the Illinois General Assembly used the term tangible personal property in its definitions of retailing and manufacturing, two of the three classes of persons entitled to the credit. 35 ILCS 5/201(e)(3). That narrow context, as it relates to the legislative purpose to make available a tax credit to persons primarily engaged in retailing, is nearly identical to the context in which the term tangible personal property relates to retailer, as those terms are used within the ROTA. Within the broader context of the IITA, the Illinois General Assembly has — even before the credit at issue was created — consistently used the term tangible personal property in sections in which it has distinguished between the tax treatment of transactions involving tangible personal property and the tax treatment of transactions involving intangible property, or transactions involving property other than tangible personal property. 35 ILCS 5/303(a)(2)-(3); 35 ILCS 304(a)(1), (3)(B)-(C). Again, in both of these narrow and broader contexts, the text that the Illinois General Assembly used in the IITA has dovetailed with the Illinois Supreme Court's judicial construction, in Farrand Coal Co. and in other cases, that a producer of electricity is *not* engaged in the business of selling tangible personal property at retail, and that tangible personal property does *not* include intangible personal property.

Most of the documents XYZ cites discuss one section of the IRC in which Congress used the term tangible personal property in the context of which taxpayers must use a particular method of accounting, mandated by Congress in 1986. 2001 WL 1659980 (Sept. 25, 2001) (IRS PLR); 2001 WL 1638435 (IRS CCA) (Sept. 18, 2001); 2001 WL 1451836 (IRS PLR) (June 20, 2001); 2001 WL 1451856 (IRS PLR) (Aug. 14, 2001). But for the technical advice memorandum,[3] those documents consist of the IRS's denials of separate requests for consent to change a taxpayer's method of accounting for inventory costs. 2001 WL 1659980 (Sept. 25, 2001) (IRS PLR); 2001 WL 1638435 (IRS CCA)

---

3 The technical advice memorandum (hereinafter, "TAM") was written in response to a revenue agent's request that a taxpayer be required to change, for tax purposes, its cash method of accounting to an accrual method, so as to account for inventory. 1995 WL 397457 (IRS TAM) (Feb. 15, 1995). The IRC sections referred to in the TAM were §§ 446 and 471, which provide, respectively, the General Rule for Methods of Accounting, and the General Rule for [Accounting for] Inventories. *Id*.; 26 U.S.C. §§ 446, 471. In neither of those sections did Congress use the term tangible personal property. 26 U.S.C. §§ 446, 471. Section 446 of the IRC, *inter alia*, allows the IRS to require a taxpayer to change its method of accounting for tax purposes, if, in the opinion of the Secretary of the Treasury, the method used by the taxpayer does not clearly reflect income. 26 U.S.C. § 446(b). Section 471, *inter alia*, provides that, "Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income." 26 U.S.C. § 471(a).

The TAM XYZ cites approved the auditor's request to have the taxpayer change its method of accounting so as to include inventory, based on the following determinations:

> **We believe that the electricity produced at Taxpayer's A is merchandise under § 1.471-1.** The production of electricity involves manufacturing or the process of manufacturing, and the weight of authority holds that electricity produced by machinery for commercial purposes is personal property or a commodity. **Minnesota Power & Light Co. v. Personal Property Tax, 182 N.W.2d 685, 690- 691 (Minn.1970). See Spillman v. Interstate Power Co., 226 N.W. 427, 433 (Neb.1929); Curry v. Alabama Power Co., 8 So.2d 521 (Ala.1942). See also Wilkinson-Beane, Inc. v. Commissioner, 420 F.2d 352, 354-355 (1st Cir.1970), aff'g T.C. Memo. 1969-79 (caskets are merchandise because they played a central role in the sale of the taxpayer's funeral services [FN2]); Knight-Ridder Newspapers, Inc. v. United States, 743 F.2d 781, 790 (11th Cir.1984) (newspapers sold to public are merchandise); Surtronics, Inc. v. Commissioner, T.C. Memo. 1985-277 (precious metals electroplated to component parts of electronic equipment owned by customers are merchandise).**

1995 WL 397457 (IRS TAM) (Feb. 15, 1995) (emphasis added).

Thus, to support its claim that it is primarily engaged in retailing, XYZ curiously relies on an IRS determination that categorizes an electrical producer as a *manufacturer* of personal property or commodities. Since XYZ's motion is based on its assertion — at least, as of this writing — that it is primarily engaged in retailing, not manufacturing, the TAM offers no support for XYZ's claim. XYZ, moreover, has expressly conceded that it "is not arguing that 'commodities' as that term is used in 35 ILCS 5/201(e)(3), includes intangibles." Order, dated 3/8/05.

(Sept. 18, 2001); 2001 WL 1451836 (IRS PLR) (June 20, 2001); 2001 WL 1451856 (IRS PLR) (Aug. 14, 2001). Each of those documents invokes and applies IRC § 263A, which section is titled, "Capitalization and inclusion in inventory costs of certain expenses," to the facts recited in the taxpayer's Application for Change in Accounting Method. *Id.*; 26 U.S.C. § 263A. In each, the same IRS employee based his conclusion, in part, on the following determination, "Producers of electricity are subject to IRC § 263A. Generation of electricity constitutes production of tangible personal property. ***" 2001 WL 1659980 (Sept. 25, 2001) (IRS PLR); 2001 WL 1638435 (IRS CCA) (Sept. 18, 2001); 2001 WL 1451836 (IRS PLR) (June 20, 2001); 2001 WL 1451856 (IRS PLR) (Aug. 14, 2001).

Section 263A is situated within Part IX (Items Not Deductible) of Subchapter B (Computation of Taxable Income), of Subtitle A (Income Taxes) of Title 26 (the IRC) of the United States Code. *See* 26 U.S.C. § 1 *et seq*. Section 263A sets forth what are commonly known as the uniform capitalization (UNICAP) rules. *E.g.*, Suzy's Zoo v. Comm'r, 114 T.C. 1 (2000). In general, § 263A(a)(1)'s UNICAP rules mandate that the costs allocable to certain property be included in the cost of inventory if such property is inventory, or capitalized if such property is not inventory. 26 U.S.C. § 263A;[4] Carpenter v.

---

4 Specifically, the applicable portions of that section provide:

> **263A. Capitalization and inclusion in inventory costs of certain expenses**
>
> **(a) Nondeductibility of certain direct and indirect costs. --**
>
> **(1) In general. -- In the case of any property to which this section applies, any costs described in paragraph (2) --**
>
> **(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and**
>
> **(B) in the case of any other property, shall be capitalized.**
>
> **(2) Allocable costs. -- The costs described in this paragraph with respect to any property are--**
>
> **(A) the direct costs of such property, and**

Comm'r, T.C.M. (CCH) 3126 (1994). Congress uses the term tangible personal property in one subsection of IRC § 263A. 26 U.S.C. § 263A(b)(1).

The first thing to notice about the text of IRC § 263A itself, is that Congress' only express statement of what tangible personal property means is that it "shall include a film, sound recording, video-tape, book or similar property." 26 U.S.C. § 263A(b)(2)(C) (*quoted supra*, n.4)). The second thing to note is the context in which Congress uses the term. The term tangible personal property appears in the first of two subsections in which Congress describes the two classes of property to which § 263A applies, specifically, to "[r]eal or tangible personal property produced by the taxpayer." 26 U.S.C. § 263A(b)(1). The other

---

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

(b) Property to which section applies. -- Except as otherwise provided in this section, this section shall apply to --

(1) Property produced by taxpayer. -- Real or tangible personal property produced by the taxpayer.

(2) Property acquired for resale. --

(A) In general. -- Real or personal property described in section 1221(a)(1) which is acquired by the taxpayer for resale.

(B) Exception for taxpayer with gross receipts of $10,000,000 or less. -- Subparagraph (A) shall not apply to any personal property acquired during any taxable year by the taxpayer for resale if the average annual gross receipts of the taxpayer (or any predecessor) for the 3-taxable year period ending with the taxable year preceding such taxable year do not exceed $10,000,000.

(C) Aggregation rules, etc.--For purposes of subparagraph (B), rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply. For purposes of paragraph (1), the term "tangible personal property" shall include a film, sound recording, video tape, book, or similar property.

***

class of property to which IRC § 263A applies is "[r]eal or personal property described in section 1221(a)(1) which is acquired by the taxpayer for resale." 26 U.S.C. § 263A(b)(2).[5] Thus, Congress has linked tangible personal property to the term produce, and not to the term retailing, as the Illinois General Assembly did in IITA § 201(e)(3).

If the documents XYZ relies on can be said to establish anything, it is that the IRS takes an expansive view of the class of producers that are required to use § 263A's UNICAP rules. 2001 WL 1659980 (Sept. 25, 2001) (IRS PLR); 2001 WL 1638435 (IRS CCA) (Sept. 18, 2001); 2001 WL 1451836 (IRS PLR) (June 20, 2001); 2001 WL 1451856 (IRS PLR) (Aug. 14, 2001). This is to be expected, since "the term 'produce' is to be broadly construed under § 263A." Suzy's Zoo v. Commissioner, 273 F.3d 875, 879 (9th Cir. 2001). By applying the term produce broadly, the IRS requires many different types of producers — for example, producers of movies or music, which is only to say, as is the case here, persons whose business includes the production of things that may not otherwise be considered tangible personal property — to capitalize certain costs associated with their business, instead of deducting such costs in the year expended. *See* 26 U.S.C. § 263A(g).

The IRS's expansive view of the class of producers that must use § 263A's UNICAP rules is wholly consistent with Congress's purpose in passing that section of the IRC. The United States Tax Court, in Von-Lusk v. Commissioner, described that underlying purpose, in part, by quoting part of the Senate Finance Committee's comments:

> The committee believes that the present-law rules

---

26 U.S.C. § 263A (emphasis added).

[5] **Section 1221(1) of the IRC includes: "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business …." 26 U.S.C. § 1221(a)(1); Hustead v. Comm'r, T.C.M. 1994-374 (Aug. 8, 1994) *aff'd* 61 F.3d 895 (3rd Cir. 1995).**

> regarding the capitalization of costs incurred in producing property are deficient in two respects. First, the existing rules may allow costs that are in reality costs of *producing*, acquiring, or *carrying* property to be deducted currently, rather than capitalized into the basis of the property and recovered when the property is sold or as it is used by the taxpayer. This produces a mismatching of expenses and the related income and an unwarranted deferral of taxes. Second, different capitalization rules may apply under present law depending on the nature of the property and its intended use. These differences may create distortions in the allocation of economic resources and the manner in which certain economic activity is organized.
>
> The committee believes that, in order to more accurately reflect income and make the income tax system more neutral, a single, comprehensive set of rules should govern the capitalization of costs of producing, acquiring, and holding property, including interest expense, subject to appropriate exceptions where application of the rules might be unduly burdensome.

Von-Lusk v. Comm'r, 104 T.C. at 214-15 (*quoting* S.Rept. 99-313 (1986), 1986-3 (Vol. 3) C.B. 140) (emphasis original).

But neither logic nor IITA § 102 dictate that, since the IRS takes an expansive view of the types of producers that must use IRC § 263A's UNICAP accounting rules, and since both IRC § 263A(b)(1) and IITA § 201(e)(3) contain the term tangible personal property, the Department is thereby obliged to take a similarly expansive view of the types of persons the Illinois General Assembly intended to include in § 201(e)(3)'s definition of retailing. Producing and retailing are not synonyms, and the IRC's definition of produce is not similar to the IITA's definition of retailing. *Compare* 26 U.S.C. § 263A(g) *with* 35 ILCS 5/201(e)(3). Further, the three specifically defined classes granted a credit pursuant to IITA § 201(e) simply do not include the many different types of producers described within IRC § 263A(g), who are required to use the § 263A UNICAP accounting rules. Indeed, one Illinois court has recently held that a taxpayer's method of accounting is not even relevant to whether the item accounted for is subject to a substantive provision of an Illinois tax act. Ogden Chrysler Plymouth, Inc. v. Bower, 348 Ill. App. 3d 944, 954, 809 N.E.2d 792, 801 (1st Dist. 2004) (holding that a taxpayer's "accounting treatment is irrelevant for purposes of determining whether [certain] payments are taxable.").

Were I to accept XYZ's argument that IITA § 102 requires me to conclude that tangible personal property, as used in IITA § 201(e)(3), means the same thing that the IRS says it means when used in IRC § 263A(b)(1), I would be substituting the IRS's view of the class of producers required to use IRC § 263A's UNICAP rules for the Illinois General Assembly's unambiguous definition of retailing. *Compare* 26 U.S.C. § 263A(b)(1) *and* (g) *with* 35 ILCS 5/201(e)(3). That is to say, if XYZ's argument were accepted, anyone that could prove that it is required to use IRC § 263A's UNICAP rules as a producer of tangible personal property would be able to establish that it is engaged in retailing, as defined in IITA § 201(e)(3). Because treating any such producer as being engaged in retailing is so clearly inconsistent with the express text of IITA § 201(e) (*see* 35 ILCS 5/201(e)(3); 86 Ill. Admin. Code § 100.2100(e)(9)(A)-(D) (list of activities not considered to be retailing operations for purposes of IITA § 201(e)(3)), and with the meaning of tangible personal property as that term is used elsewhere within the IITA (*see* 35 ILCS 5/303(a)(2)-(3); 35 ILCS 304(a)(1), (3)(B)-(C)), I reject XYZ's suggestion that the Illinois General Assembly intended IITA § 102 to require such a construction.

Even if IITA § 102 did not include its initial clause, I would still recommend that the Director not engraft upon IITA § 201's definition of retailing the IRS's view that, for purposes of IRC § 263A(b)(1), an electric utility company is engaged in the business of producing tangible personal property. The context in which the IRS undertook its view of the terms produce and tangible personal property, in IRC § 263A(b)(1), is very different from, and thus, not comparable to, the context in which the Illinois General Assembly has used the terms retailing and tangible personal property within IITA § 201(e)(3). 35 ILCS 5/102. It is also not comparable to the context in which the Illinois Supreme Court has construed the same terms for over fifty years. Farrand Coal Co., 10 Ill. 2d at 512-13, 140 N.E.2d at 701.

Whether Electricity Constitutes Tangible Personal Property As A Matter Of Scientific Fact

XYZ asserts that electricity is tangible personal property as a matter of scientific fact because it: (1) is both physical and material (XYZ's MSJ, p. 6 & Exs. A (Fajans' Affidavit, ¶ 2), A-1 (Fajans' report, pp. 1, 5, 15)); (2) can be sensed, measured, stored and weighed (XYZ's MSJ, p. 6 & Ex. A-1 (p. 5)); (3) is easily stored (XYZ's MSJ, p. 6 & Ex. A-1 (pp. 7-9)); and (4) has mass and weight (XYZ's MSJ, p. 6 & Ex. A-1 (p. 12)). XYZ argues that the proceedings in other courts, and specifically, the facts and evidence considered by the Illinois Supreme Court in the Farrand Coal Co. decision, cannot be considered here, because the expert testimony in that case is not part of this record. XYZ's MSJ, pp. 4-5. XYZ contends that:

> If the properties of electricity are a question of law, as the Department submits, then *XYZ* is entitled to judgment because the controlling authorities — that is, the [IITA], and by reference, the federal income tax laws — hold that electricity is tangible property. However, if the properties are a question of fact, then the taxpayer is *still* entitled to summary judgment because there are no facts of record contradicting Fajans' expert testimony that, as a matter of objective scientific fact, electricity is both physical and material.

XYZ's MSJ, p. 7 (emphasis original).

If the properties of electricity were at issue in this case, that issue would constitute an issue of fact. But neither party disputes the properties of electricity. Since the parties filed cross-motions for summary judgment, the dispute is one of law. Lake Co. Stormwater Mgmt. Comm. v. Fox Waterway Agency, 326 Ill. App. 3d at 104, 759 N.E.2d at 973.

If, however, this matter *did* call into question the properties of electricity, I would be able to take notice of scientific facts that are well established by authoritative scientists and which are generally accepted as irrefutable by living scientists, since such facts may be judicially noticed by Illinois courts. Cook Co. Dept. of Environmental Control v. Tomar Industries, Div. of Polk Bros., 29 Ill. App. 3d 751, 754, 331 N.E.2d 196, 199 (1st Dist. 1975); *see also* 27A Am. Jur. 2d *Energy and Power Sources* § 438 ("Since the courts take judicial notice of the laws of nature and of nature's powers and forces, they therefore take judicial notice of electricity and its properties …."). While I am not taking notice of such facts in this case, I do note that nothing in Fajans' affidavit or report suggests that the fundamental properties of electricity have somehow changed or evolved since the time the Illinois Supreme Court entered its decision in Farrand Coal Co. *Compare*, *e.g.*, Farrand Coal Co. *with* XYZ's MSJ, pp. 6-7 & Exs. A (Fajan's Affidavit, ¶ 2), A-1 (Fajan's report, pp. 1, 5, 7-9, 10-12, 15)). While it may be safe to presume that the capabilities and/or technical sophistication of the sensing, measuring and storage devices described by Fajans have improved since the time of the Court's Farrand Coal Co. decision, I will not presume that the fundamental properties of electricity have changed.

Since this matter involves only a question of law, I am able to note that the same fundamental legal issues presented here were presented in the analogous case of Farrand Coal Co.: did the Illinois General Assembly intend electricity to be embraced within the meaning of the term tangible personal property, as that term is used in § 201(e)(3) of the IITA (and as that term was also used within the ROTA, when Farrand Coal Co. arose); and is a provider of electricity primarily engaged in retailing, as that term is defined in § 201(e)(3) of the IITA (and as the word retailer was used in the ROTA in 1957)? The Illinois General Assembly has consistently articulated, within the IITA itself, a distinction between tangible personal property and intangible property. *E.g.*, 35 ILCS 5/303, 304. Thus, nothing within XYZ's motion leads me to conclude that when the Illinois legislature used the phrase tangible personal property in § 201(e)(3)'s definition of retailing, it intended to include within that phrase intangible property, like electricity.

Whether The Department's Enforcement Of § 201(e) Violates The Illinois Constitution's Uniformity Clause

XYZ argues that if it is not granted the credit claimed here, the Department's enforcement of the § 201(e) credit would violate the Uniformity Clause of the Illinois Constitution. XYZ's MSJ, pp. 9-14. The uniformity clause states that, "[i]n any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable." Ill. Const.1970, art. IX, § 2; Geja's Cafe v. Metropolitan Pier & Exposition Authority, 153 Ill. 2d 239, 247, 606 N.E.2d 1212, 1215 (1992).

Initially, I note that the Illinois Supreme Court has acknowledged that since "[s]tatutes are presumed constitutional, and broad latitude is afforded to legislative classifications for taxing purposes[,]" its scope of inquiry when reviewing such challenges is relatively narrow. Geja's Cafe, 153 Ill. 2d at 248, 606 N.E.2d at 1216. A person challenging such a classification has the burden of showing that it is arbitrary or unreasonable, but if a state of facts can be reasonably conceived that would sustain it, the classification must be upheld. *Id*.

In its motion, XYZ argues that the Department "has admitted to allowing a combined gas and electric utility to claim the investment credit for property used in the taxpayer's electric utility business. (Dept's Resp. to Taxpayer's 1st Request to Admit Facts, No. 4). And, while MMM itself is not a combined gas and electric utility company, the distinction is wholly arbitrary." XYZ's MSJ, p. 10. XYZ, however, either misstates or misconstrues the Department's response to its request to admit. The Department's Response and XYZ's specific request to admit are as follows:

> Request 4: The Department had granted the personal property replacement income tax credit as referenced in 35 ILCS 5/201(e) to a "regulated" electric utility.
> Answer: [precatory objections omitted]
> Without waiving its objection, the Department hereby denies that it has "granted" the personal property replacement income tax credit as referenced in 35 ILCS 5/201(e) to a "regulated" electric utility. However, between the tax years 1992 and 1998, a combined gas and electric utility did file an amended return claiming the Credit for property used in its electricity business. The Department did not audit the amended return and the taxpayer received the benefit of the Credit.

Department's Response to [XYZ's] Cross-Motion for Summary Judgment and Reply to [XYZ's] Response to the Department's Motion for Summary Judgment ("Department's Response"), pp. 12-13 (emphasis original).

The Department did not admit that it determined that a combined gas and electrical utility company was entitled to a credit for the property used in the company's electric utility business. Rather, the Department's admission is that it did not audit a particular company's amended returns, and that, as a result, that particular company received the benefit of the credit. Read *in toto*, the Department did not so much admit that it granted a § 201(e) credit to a taxpayer in the same business as XYZ, as it admitted that it processed a particular taxpayer's amended returns without determining, as a matter of fact (which, after all, is one of the functions of an audit), that the taxpayer was entitled to the credit claimed. The Illinois Constitution's uniformity clause, however, was never intended to bestow a constitutional right of equal treatment for a taxpayer who has discovered that Illinois' tax collector has mistakenly allowed a credit in a situation where the credit should not have been allowed, or mistakenly failed to assess tax in a situation where tax was due. The clause was intended to provide relief from arbitrary legislative classifications, not to require an agency to perpetuate any mistake it might have made in administering the legislature's acts. *See* Geja's Cafe, 153 Ill. 2d at 252, 606 N.E.2d at 1218 ("The uniformity clause was not designed as a straitjacket for the General Assembly. Rather, the uniformity clause was designed to enforce minimum standards of reasonableness and fairness as between groups of taxpayers.").

XYZ also invokes the uniformity clause because the Department allows, that is to say, it has made a policy decision to grant, such credits to natural gas utility companies, but not to electrical utility companies. *See* XYZ's MSJ, pp. 11-14. XYZ asserts that, "there is no possible justification for discriminating between natural gas and electric companies when it comes to the object of the investment credit statute." *Id*. at 12.

Classifications within nonproperty tax acts must be based on real and substantial differences between those taxed and not taxed, and must bear some reasonable relationship to the object of the legislation or to public policy. Geja's Cafe, 153 Ill. 2d at 247, 606 N.E.2d at 1215 (referring to this as "the Searle test," as previously announced in Searle

Pharmaceuticals, Inc. v. Department of Revenue, 117 Ill.2d 454, 512 N.E.2d 1240 (1987)). When a good-faith uniformity challenge is made, a taxing body must produce a justification for its classifications. The taxpayer then has the burden to persuade that the defendant's explanation is insufficient as a matter of law, or unsupported by the facts, to satisfy the Searle test. Geja's Cafe, 153 Ill. 2d at 248-49, 606 N.E.2d at 1216.

Here, and in response to XYZ's uniformity challenge, the Department counters that the real and substantial differences between persons engaged in the business of selling natural gas and those, like MMM, who are engaged in the business of selling electricity, is that the former are selling tangible personal property (Archer Daniels Midland Co. v. City of Chicago, 294 Ill. App. 3d 186, 689 N.E.2d 392 (1st Dist. 1997)), whereas the latter are providing others with intangible property. Farrand Coal Co., 10 Ill. 2d at 513, 140 N.E.2d at 701. This distinction, moreover, is one that has been pronounced by judicial determination, and not established by the legislature. I agree that there is a real and substantial difference in the classes of persons to whom the credit is available, and that this difference is related to Illinois' longstanding public policy of treating differently, for tax purposes, persons who sell tangible personal property versus persons who do not. Since IITA § 201(e)(3)'s very definition of retailing hinges on whether a person is selling tangible personal property, moreover, the real and substantial difference between natural gas utilities (which sell tangible personal property) and electric utilities (which do not), is also related to the purpose of the § 201(e) credit. 35 ILCS 5/201(e)(2)(D), (e)(3).

Conclusion:

Because it does not sell tangible personal property, XYZ is not primarily engaged in retailing, as that term is defined in § 201(e)(3) of the IITA. Treating electric utilities differently than natural gas utilities, for purposes of § 201(e) of the IITA, does not violate the uniformity clause of the Illinois Constitution. I recommend, therefore, that the Director grant the Department's Motion, that he deny XYZ's Motion, and that he finalize the denials previously deemed issued, pursuant to statute.

Date: 7/7/2005

John E. White
Administrative Law Judge